Wednesday, November 29, 2000

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re

ROBERT FRANKLIN WILLIAMS, No. 00-12004

Debtor(s).

_____/

Memorandum re Plan Confirmation

Debtor Robert Williams has proposed a Chapter 13 plan which proposes to pay two unsecured creditors in full, with nothing to the other unsecured creditors. Williams is obligated to pay these debts and hold his former spouse harmless from them pursuant to a state court marital settlement. The plan also provides for interest on these unsecured debts, and purports to discharge Williams' former spouse, who is not a debtor, of any liability for the two debts even though she is jointly liable on them as a matter of law. The Chapter 13 trustee has objected. The court treats the three issues raised (classification, postpetition interest, and discharge of a non-debtor) separately.

1. Classification

This dispute over proper classification is governed by § 1322(b)(1) of the Bankruptcy Code, which provides: (b) Subject to subsections (a) and (c) of this section, the plan may-- (1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with

the debtor differently than other unsecured claims. All of the language after "designated" was added by amendment in 1984. In the very rare case, discrimination between unsecured debt is fair. See, e.g., this court's decision in In re Patin, 201 B.R. 539 (Bkrtcy.N.D.Cal. 1995). However, almost all of the time such discrimination is unfair, even when the debt to be paid is child support or a student loan. In re Sperna, 173 B.R. 654 (9th Cir. BAP 1994); In re Burns, 216 B.R. 945 (Bkrtcy. S.D.Cal. 1998). The crux of this case is the statutory construction of § 1322(b)(1), as amended. The issue is whether discrimination in favor of a consumer debt with a co-debtor still has to be fair. The statute clearly exempts co-debtor debt from the fairness requirement. The use of the word "however" creates an unambiguous exception to the general requirement of fairness. The intent of the statute is clear: a fairness inquiry is not required where the basis of the separate classification is the existence of a co-debtor. In this regard, the court believes that the district court in In re Gonzales, 172 B.R. 320, 329 (E.D.Wash. 1994), got it wrong when it required the debtor to justify the fairness of separate classification of a co-signed consumer debt. This conclusion is nothing more than giving proper effect to a simple and unambiguous statute. It does not mean that in all cases a plan which separately classifies co-signed debt must be confirmed, but only that the basis of denial of confirmation may not be unfairness to the other unsecured debt. The debtor still must convince the court that the plan has been proposed in good faith. 11 U.S.C. § 1325(a)(3). In the unusual case where the debtor is ineligible for Chapter 7[(1)], the court might well find that a plan which discriminated between unsecured debt was a bad faith manipulation of the Bankruptcy Code which required its rejection. However, in the ordinary case where the debtor has a Chapter 7 option and the other creditors would get nothing in Chapter 7 anyway confirmation may not be denied just because the plan separately classifies co-signed debt, and the court may not impose the fairness test on the classification. Even if the fairness test is applicable, Williams has made out a good case that his separate classification of the co-signed debt is fair. The test for fairness of classification is whether the discrimination has a reasonable basis, whether the debtor can carry out a plan without the discrimination, whether the discrimination is in good faith, and whether the degree of discrimination is related to the basis for discrimination. In re Wolff, 22 B.R. 510, 512 (9th Cir. BAP 1982). In this case, the reason for the discrimination is clear and compelling: Williams' fragile relations with his ex-wife, and his connection to his children, will be destroyed if he does not honor his divorce settlement obligations. His ex-wife earns only $1000.00 per month from a paper route, and cannot afford to pay the debts in question. Given Williams' meager income, he cannot afford to do better than he proposes to the other creditors, who would receive nothing in a Chapter 7 case anyway. The court accordingly finds that while the fairness test is not applicable to co-signed debt, the court would find that Williams has met the test if it were applicable.

2. Postpetition Interest The court declines to follow the holding in In re Austin, 110 B.R. 430 (Bkrtcy.E.D.Mo. 1990) to the effect that § 502(b)(2) of the Bankruptcy Code can be trumped by Chapter 13 provisions. Section 502 sets forth what sorts of claims can be allowed. The plan may only deal with allowed claims, and may not create new categories of claims not allowable under § 502. The court notes that since the allowed amount of claims to be paid through the plan is lower, the plan will have a shorter duration and Williams will be free, upon payment of the claim, to satisfy any remaining postpetition interest.

3. Discharge of Nondebtor

It is generally not within the province of a plan to provide for the discharge of anyone other than the debtor. Nor would discharge of Williams' former wife be appropriate since postpetition interest is not allowable and will remain owing after discharge. Williams will

therefore have to rely on the co-debtor stay of § 1301 to protect his former spouse.[2] For the foregoing reasons, the court will overrule the trustee's objection to separate classification of the two credit card debts. His objection to the plan provision providing for unmatured interest will be sustained. The provision of the plan providing that the debtor's ex-wife to be "absolved of all liability . . . on completion of debtor's plan" will not be approved. Counsel for the debtor may either submit an order denying confirmation or an order confirming a plan which has been amended to eliminate provisions for postpetition interest and "absolution" of the non-debtor ex-wife.

Dated: November 29, 2000

_____

Alan Jaroslovsky

U.S. Bankruptcy Judge

1. For instance, if the debtor had a recent prior Chapter 7 discharge or had been denied Chapter 7 relief pursuant to § 707(b).

2. The court would have no objection to a brief delay in closure of the case, after plan payments have been completed, to allow Williams to deal with any remaining liab

---